IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 84 of 1984

For Approval and Signature:

Hon'ble MR.JUSTICE R.BALIA. and
MR.JUSTICE A.R.DAVE

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1. Whether Reporters of Local Papers may be allowed to see the judgements? Yes

2. To be referred to the Reporter or not? Yes T be referred to the Reporter or not? Yes To be referred to the Reporter or not? Yes To be referred to the Reporter or not? Yes To be referred to the Reporter or not? Yes To be referred to the Reporter or not? Yes To be referred to the Reporter or not? Yes To be referred to he Reporter or not? Yes To be referred to the Reporter or ot? Yes To be referred to the Reporter or not? Yes To be referred to the Reporter or not? Yes To e referred to the Reporter or not? Yes To be referred to t e Reporter or not? Yes To be referred to the Reporter or n t? Yes To be referred to the Reporter or not? Yes To be referred to the Reporter or not? Yes To b referred

3. Whether Their Lordships wish to see the fair copy of the judgement? No

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? No

5. Whether it is to be circulated to the Civil Judge? No

SHREE NIKETAN

Versus

COMMISSIONER OF INCOME-TAX

Appearance:

MR JP SHAH for Petitioner

MR RP BHATT for Respondent No. 1

CORAM : MR.JUSTICE R.BALIA. and
MR.JUSTICE A.R.DAVE
Date of decision: 10/11/98

ORAL JUDGEMENT (per R. Balia, J.)

A consolidated statement of case for the Assessment Years 1973-74, 1974-75 and 1975-76 has been submitted to this court by the Income Tax Appellate Tribunal, Ahmedabad Bench 'B'. The following question of law arising out of its composite order for the three assessment years in Income Tax Applications Nos. 1967, 1646 and 1647 (Ahd)/79 has been referred to this court for its decision.

"Whether, on the facts and in the circumstances of the case, the assessee would be entitled to claim deduction in respect of irrecoverable rent from M/s. Dadaji Dhagji & Co. and M/s. De Smet India Pvt. Ltd. both in respect of earlier years as well as the years under reference u/s 24(1)(x) of the Income-tax Act, 1961 read with Rule 4 of the Income-tax Rules, 1962?"

2. As the question suggests, it relates to claim of the assessee to deduct arrears in respect of amount received by it from the two occupiers of its properties, namely, M/s. Dadaji Dhagji & Co. and M/s. De Smet India Pvt. Ltd. relating to earlier period of these assessment years.

3. At the outset it has been stated by the learned counsel for the assessee Mr. J.P. Shah that, as the amount claimed as irrecoverable has, in fact, been received by the assessee in the later years, he does not press for his claim to deduction in respect of M/s. Dadaji Dhagji & Co. and the consideration of question maybe confined to the claim of deduction made in respect of M/s. De Smet India Pvt. Ltd. only.

4. The facts necessary for the present purposes relating to the claim of deduction regarding unrealised rent/licence fee from M/s. De Smet India Pvt. Ltd. while computing income under the head 'Income from House Property' may be noticed. For Assessment Year 1973-74, the assessee has claimed a deduction of Rs. 75,504/- in respect of unrealised rent. For Assessment Year 1974-75, the claim for deduction on account of irrecoverable rent from the said occupant was Rs. 1,88,716/- and for the

Assessment Year 1975-76 the claim was for a sum of Rs. 3,02,060/which included the arrears of rent for the Assessment Years 1973-74 and 1974-75 and had not been allowed as deduction in those years. The claim was to deduct such arrears from the income under the head "Income from House Property" in terms of Sec. 24(1)(x) of the Income-tax Act, 1962 which reads "Income chargeable under the head "Income from house property" shall, subject to the provisions of sub-sec. (2), be computed after making the following deductions, namely:-

xxx xxx xxx

(x) subject to such rules as may be made in this behalf, the amount in respect of rent from property let to a tenant which the assessee cannot realise."

5. Rule 4 of the Income-tax Rules provides conditions for deductibility of unrealised rent which, inter alia include the condition that the defaulting tenant should have vacated or steps should have been taken by the assessee to compel him to vacate the property and the assessee must either have taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfy the Assessing Officer that legal proceedings would be useless, apart from other conditions with which we are not presently concerned. The facts about these conditions as noticed by the Tribunal in its order concerning M/s. De Smet India Pvt. Ltd. are that notice in the first instance was given to revoke the licence for terminating the tenancy on 7.3.1972 and demand for arrears of rent/compensation for use under occupation of the house was made along with the demand to vacate the premises. Final notice in that respect was given on 28.3.1973. The assessee then filed Suit No. 37/74 in the Bombay High Court on 13.12.1973, the date which falls in the previous year relevant to Assessment Year 1975-76. Other fact noticed by the Tribunal is that the occupant also filed a suit claiming that the rent claimed by the assessee is excessive and a standard rent may be fixed. It is further noticed by the Tribunal that the said party was required to deposit certain amount by the order of the court and the same was deposited by it and, according to the assessee, the said deposit was adjusted by the appellant against the claim for which the suit was filed. Both the proceedings were pending at the time when the appeal was heard by the Tribunal. The reasoning as to the effect of filing of legal proceedings on the estimation of the assessee about the irrecoverability of

the arrears of rent was discussed by the Tribunal as under:-

> "Simply by giving notice demanding arrears of rent and terminating the tenancy would not go to show that the arrears of rent claimed by the assessee could not be realised or lost or the assessee has taken all steps for the recovery of such rent. We may again state that the assessee filed suit for the recovery of rent. This fact itself goes to indicate that he has all hopes to recover the rent in question from the assessee. If it was not so the appellant would have produced evidence before the Income-tax Officer to show that any legal proceedings would be useless against this party. From the material on record it is quite clear that the assessee did take a stand that if any legal proceedings are instituted against the party the same would be useful. The moment the suit for recovery of the arrears of rent and for the possession of the property has been filed, the assessee presupposes that the arrears of rent is realisable from the said party. So there is nothing on the record to establish that the arrears of rent due from the said party is lost or could not be realised or become irrecoverable at the time the legal proceedings were started by him."

On these reasoning, the claim of the assessee was disallowed.

6. A mere perusal of the reasoning adopted by the Tribunal goes to show that it works at cross purposes with the rule itself. Recalling the two conditions noticed by us above would reveal, firstly, that vacating the premises is not a condition precedent but is an alternative, namely, that either the defaulting tenant should have vacated, or steps should have been taken by the assessee to compel him to vacate the property. Likewise, the requirement of taking steps to institute legal proceedings is primary requirement; it is only by way of alternative to institution of legal proceedings; it has been provided that even in case the assessee has not taken recourse to legal proceedings, he may establish by evidence that taking legal proceedings would be a futile exercise and would, in fact, be counterproductive and a wasteful expense of time and money, both. The reason adopted by the Tribunal that because the suit has been instituted there is a hope of realisation, is counter to normal course of human conduct. Ordinarily,

it is only when a person is bereft of any hope to secure return of his money that he is driven to court for enforcement of his right and to ask for the succour by way of seeking assistance of the court about the declaration of his right and then further prosecute through execution proceedings if such right is declared. The question about recoverability of rent cannot be negatived on the ground that, because a person has taken recourse to civil suit for the purpose it is recoverable. Even if a person is convinced that no amount is recoverable, if, in order to have smoother way for the purpose of laying claim to deduction on account of bad debt or unrealisable rent, an assessee prefers to have recourse to legal remedy, he is not rendered in worse situation. As a matter of fact, by taking recourse to legal proceedings, the assessee is relieved primarily to prove that the debt is not recoverable in ordinary way. The Tribunal has approached the issue as if either legal proceedings must have been terminated against assessee to prove the irrecoverability of rent or he should prove the irrecoverability of such a nature, has to establish that filing of legal proceedings is a futile exercise. If the Tribunal's plea were to be accepted, the first part of the rule requiring that the assessee must take necessary steps to institute legal proceedings for recovery of arrears before he claims deduction, would be rendered otiose because, according to the reasons of the Tribunal, filing or institution of legal proceedings would itself disentitle him to urge that the arrears have become unrealisable. It is only if he puts on record dismissal of his claim or futility of filing litigation at all, the claim could be considered as unrealisable. If, after filing of legal proceedings, still the assessee has to prove that filing of litigation would have been useless, the making of provision to institute legal proceedings as a condition for claiming deduction on account of unrealised rents would be meaningless. The reasoning adopted by the Tribunal reveals that it has equated 'INSTITUTION OF LEGAL PROCEEDINGS' with TERMINATION OF LEGAL PROCEEDINGS as an alternate to proof of a futile litigation. It hardly needs elaboration that institution of legal proceedings denotes merely commencement and not its culmination. The rule requires merely taking of all steps necessary for institution or commencement of legal proceedings. Strictly speaking actual institution of legal proceedings itself is not a precondition; mere taking necessary steps for such institution is enough. For example, if law requires a notice of minimum period is necessary before instituting a suit, giving of such notice in the previous year laying the foundation for instituting the suit on expiry of notice followed with

actual filing of suit within reasonable period after expiry of notice period in succeeding year may fulfil the condition under rule 4 in the previous year relevant to assessment year in question in which notice has been given notwithstanding suit has been instituted after the end of previous year. It may be noticed that the question has to be determined not as if the rent has in fact become unrealisable and irrecoverable finally but it is founded on reasonable estimation of assessee about the possibility of its non-realisation in spite of making all efforts to recover it. The emphasis is that before laying claim the assessee must make reasonable efforts to recover it and he must establish of having made such effort and failure of such effort in yielding results until the claim is made should lead to reasonable conclusion that estimation of the assessee about irrecoverability of the rent is plausible. If there is material which indicates to other directions, the claim may be rejected. But holding the efforts to recover, which have not fructified so far, as an evidence of the fact that the rents are realisable, in our opinion, is contrary to clear language as well as object of the rule laying down the conditions for claiming such deduction.

7. It may be noticed that the Tribunal has found that notice demanding arrears of the rent and terminating the tenancy was given by the assessee as early as in March 1972 followed by another notice on 28.3.1973. It has also been noticed that suit for recovery of arrears of rent and for the possession of the property has been filed on 13.12.73. Thus, so far as condition requiring the assessee to have taken steps to compel the occupant to vacate the property and to have taken all reasonable steps to institute legal proceedings for recovery of unpaid rent are fulfilled. No further condition be read into the rules to enjoin an obligation upon the assessee either to prove a decree for vacation or recovery of rent has been passed in spite of the decree the same has become unrealisable and after filing suit for recovery of rent, which itself is evidence of the fact that rents are not recoverable voluntarily, the further proof of uselessness of such litigation is not required to be established. The assessee had brought out that amounts of rent are not being paid despite demand and he has been compelled to file suit for recovey of rent and eviction. He also established that even after filing of suit, the occupant has not paid the rent as claimed but raised dispute by filing a suit for determining standard rent, requiring reduction in payment of rent, which manifested clear intention of occupant not to pay the agreed rent on the basis of which annual letting value has been

determined and income from house property is computed. Thus, assessee has done what all it could do to take step to institute legal proceedings. He thereafter is not required to await until such litigation turns out to be an unfruitful exercise as envisaged by the Tribunal before claiming deduction under sec. 24(1)(x) of the Act.

8. However, we are of the opinion that since suit has been filed only on 13.12.1973 in the previous year relevant to Assessment Year 1975-76, the condition as to taking of steps necessary for instituting legal proceedings to have been taken by the assessee have been fulfilled in the previous year relevant to Assessment Year 1975-76 only and not prior to that date inasmuch as mere notice terminating licence and demanding arrears of rent, in the facts and circumstances of the present case, do not suffice to hold that the assessee had taken all steps to compel the occupant to vacate the property and has taken steps to institute legal proceedings for recovery of the arrears of rent, prior to making the claim. First notice was given in March 72. It was not followed by any step for another year when notice dated 28.3.73 was given and also suit has been filed almost 9 months thereafter on 13.12.73, which falls in previous year relevant to Assessment Year 1975-76, as the assessee had his previous year ending on Diwali. Thus, the claim could be considered for deduction in respect of Assessment Year 1975-76 only.

9. Thus, our answer to the question referred to us is that so far as the assessee's claim to deduction in respect of unrealisable arrears of rent from M/s. Dadaji Dhagji & Co. is concerned, the assessee does not press for such claim any more for the years in question and to that extent the disallowance of claim to deduction by the Tribunal cannot be said to be erroneous. However, so far as assessee's claim to deduction in respect of unrealised rent from M/s. De Smet India Pvt. Ltd. is concerned, the Tribunal was not justified in denying the claim for the reasons for which it has been denied to it in its order out of which this reference has arisen, and that part of the order is erroneous in law.

10. The reference stands disposed of. There shall be no order as to costs.

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